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No. 93-339

In the Supreme Court of the United States

OCTOBER TERM, 1993

JAMES W. BURKE, AS PERSONAL REPRESENTATIVE OF THE ESTATE OF EDNA SPROULL WILLIAMS, DECEASED, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

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QUESTION PRESENTED

Whether the charitable deduction claimed on the decedent's estate tax return must be reduced by the amount of the estate's administrative expenses.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 3a-17a) is reported at 994 F.2d 1576. The opinion of the Court of Federal Claims (Pet. App. 41a-51a) is unreported.[1]

JURISDICTION

The judgment of the court of appeals was entered on June 2, 1993. The petition for a writ of certiorari was filed on August 31, 1993. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

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[1] Congress changed the name of the United States Claims Court to the United States Court of Federal Claims effective October 29, 1992. Pub. L. No. 102-572, § 902(a), 106 Stat. 4516.

STATEMENT

1. Edna Sproull Williams, who was a Florida resident, died on February 28, 1982 (Pet. App. 4a). She bequeathed most of her substantial estate to the Edna Sproull Williams Foundation, a tax-exempt, charitable organization (*id.* at 43a-44a). Article XIII of decedent's will provides (Pet. App. 5a):

> I give, devise and bequeath all of the rest, residue and remainder of my estate, including all lapsed legacies or devises, after paying therefrom any debts and taxes, including estate, inheritance or succession taxes, and other obligations of my estate, including all administration expenses, to the Trustees of the EDNA SPROULL WILLIAMS FOUNDATION.

Article I of her will directs her estate, inheritance, and succession taxes to be paid solely from the residuary estate (Pet. App. 5a).

On November 11, 1982, petitioner filed a petition for will construction in the Florida probate court seeking a determination under Florida law that decedent's will authorizes the payment of administrative expenses from the estate's post-mortem income, rather than from its principal (Pet. App. 4a). On November 12, 1982—the day after the unopposed petition for construction was filed—the Florida probate court entered an order granting the requested relief and permitting payment of administrative expenses either from income or from the residuary estate, at petitioner's discretion (*id.* at 5a-6a).

On November 24, 1982, petitioner filed the estate's federal estate tax return in which he valued the gross estate at $10,489,753.94 and claimed total deductions of

$9,747,444.42, leaving a taxable estate of $742,309.52. The claimed deductions included charitable deductions totaling $9,662,605.10, of which $8,869,080.10 represented the residuary bequest to the Foundation (Pet. App. 6a). Petitioner did not deduct the administrative expenses, which totaled $144,441, on the estate tax return. *Ibid.* Instead, he elected to deduct them on the estate's income tax return filed April 5, 1983, on the asserted ground that they were paid from post-mortem income (*id.* at 44a).

The estate was administered for seven years, during which time it earned substantial income (Pet. App. 13a). That income augmented the residuary bequest of $8,869,080 (Pet. 10), and the Foundation eventually received total distributions of $10,091,707 (*ibid.*).

On audit, the Internal Revenue Service determined that the administrative expenses claimed as a deduction on the estate's income tax return instead should have been shown on its estate tax return as reducing the charitable deduction of $8,869,080.10 for the residuary bequest to the Foundation. This adjustment reduced the charitable deduction on the estate tax return by $236,536.38—the amount of the administrative expenses plus the estate taxes attributable thereto. The Service therefore assessed an estate tax deficiency of $80,110.87 (Pet. App. 6a-7a).

Petitioner paid the deficiency, plus interest, and commenced this refund suit (Pet. App. 7a, 51a).

2. The parties submitted the case to the trial court on cross-motions for summary judgment. The trial court accepted, for purposes of the motions, petitioner's claim that the administrative expenses were paid from post-mortem income. The court determined,

however, that the charitable deduction had to be reduced by the amount paid for administrative expenses from post-mortem estate income because, under federal law, "post-mortem estate income may not be used to increase the charitable deduction" (Pet. App. 47a). The court further held (i) that administrative expenses must be charged to principal under the terms of the will and under Florida law (Fla. Stat. Ann. § 738.05(1) (West 1991)) (Pet. App. 47a-51a) and (ii) that, under *Commissioner* v. *Estate of Bosch*, 387 U.S. 456 (1967), the Florida probate court order is not binding in determining the requirements of the federal estate tax (Pet. App. 50a). The court therefore granted the government's motion for summary judgment (*id.* at 51a).

3. The court of appeals affirmed. The court held that the proper characterization of administrative expenses under the federal estate tax is an issue controlled by federal, not state, law (Pet. App. 9a-10a & n.5). The court concluded that, under the federal estate tax (Pet. App. 12a):

> when a decedent dies, a finite amount known as the gross estate is legally created. Any deductions for expenses incurred in administering the estate are theoretically derived from this amount and, regardless of the actual source of payment, must be accounted for within the gross estate.

The court noted that the term "gross estate" is defined as "the value *at the time of death* of all [decedent's] property" (Pet. App. 10a, quoting 26 U.S.C. 2031(a)). The term "taxable estate" is the "gross estate" less allowed deductions (Pet. App. 11a, citing 26 U.S.C. 2051, 2053).

The court noted that, in computing the charitable deduction for the estate tax, the relevant inquiry is the amount received by the charity from the gross estate. The additional sums thereafter distributed to the Foundation from post-mortem income represent charitable deductions for the estate's *income* tax, not for the estate tax itself—and the estate had already received a charitable deduction for the distributions from post-mortem income on its federal income tax returns (Pet. App. 13a-14a).

The court distinguished the present case from *Estate of Warren* v. *Commissioner*, 981 F.2d 776 (5th Cir. 1993), which held that the Tax Court was bound by a state probate court's judgment that 72 1/2% of the administrative expenses were chargeable to post-mortem income (Pet. App. 14a-16a). The court of appeals noted that in *Warren* the state probate court judgment "resulted from a bona fide adversarial proceeding between the various beneficiaries under the will," while here "there was no *bona fide* adversarial proceeding leading to the Florida probate court's decision" (Pet. App. 16a). The court further noted that state court decisions cannot bind federal courts in the interpretation of federal estate tax provisions and that, if *Warren* were interpreted to hold to the contrary, it would be inconsistent with prior decisions from that same circuit (Pet. App. 17a, citing *Alston* v. *United States*, 349 F.2d 87 (5th Cir. 1965)).

ARGUMENT

The decision of the court of appeals is correct and does not conflict with any decision of this Court or any other court of appeals. Further review is therefore not warranted.

1. Administrative expenses are charges against the gross estate regardless of the source for their payment. The federal estate tax is imposed on "the transfer of the taxable estate." 26 U.S.C. 2001(a). Under Section 2051, the taxable estate is defined as the gross estate less the deductions permitted by Sections 2053-2056.[2] In particular, Section 2053(a) provides that "the value of the taxable estate shall be determined by deducting from the value of the gross estate such * * * administration expenses * * * as are allowable by the laws of the jurisdiction * * * under which the estate is being administered." 26 U.S.C. 2053(a). The gross estate includes "the value *at the time of* * * * *death* of all property, real or personal, tangible or intangible, wherever situated." 26 U.S.C. 2031(a) (emphasis added).

Under Section 2055(d), the amount of a charitable deduction is limited to "the value of the transferred property required to be included in the gross estate." 26 U.S.C. 2055(d). Income received by an estate during its administration ("post-mortem income") is *not* included in the gross estate for estate tax purposes. *Bowes* v. *United States*, 593 F.2d 272, 275 (7th Cir. 1979); *Connecticut Bank & Trust Co.* v. *United States*, 465 F.2d 760, 764-765 (2d Cir. 1972); *Alston* v. *United States*, 349 F.2d 87, 88 (5th Cir. 1965). Instead, post-mortem income is includable in the estate's gross income on its income tax return. 26 U.S.C. 641(a)(3). Various deductions are permitted on the fiduciary income tax return, including a deduction for distributions to charity. 26 U.S.C. 642(c).

[2] The deductions from the gross estate include administrative expenses (Section 2053(a)(2)), charitable bequests (Section 2055) and bequests to the surviving spouse (Section 2056).

Under these provisions, the courts and commentators have generally agreed that the charitable deduction (and the similarly framed marital deduction) must be reduced by the amount of administrative expenses, even if these expenses are paid from post-mortem income. *Estate of Street* v. *Commissioner*, 974 F.2d 723, 728 (6th Cir. 1992) ("marital deduction must be reduced in light of any administrative expenses paid from principal or income"), rev'g in part 56 T.C.M. (CCH) 774 (1988); *Alston* v. *United States*, 349 F.2d at 88 (administration expenses must be deducted from the gross estate even though paid out of post-mortem income); *Ballantine* v. *Tomlinson*, 293 F.2d 311, 313 (5th Cir. 1961); *Estate of Horne* v. *Commissioner*, 91 T.C. 100 (1988); *Rifkind* v. *United States*, 5 Cl. Ct. 362, 374 (1984). See also 4 J. Rabkin & M. Johnson, *Federal Income, Gift and Estate Taxation* § 59.07, at 5985 (1992). Congress expressly considered, and rejected, the suggestion that an estate should be allowed to increase the marital deduction by using estate income to pay claims against the estate (S. Rep. No. 1013, 80th Cong., 2d Sess. Pt. 2, at 6 (1948) (emphasis added)):

> The interest passing to the surviving spouse from the decedent is only such interest as the decedent can give. If the decedent by his will leaves the residue of his estate to the surviving spouse and she pays, or *if the estate income is used to pay, claims against the estate so as to increase the residue*, such increase in the residue is acquired by purchase and not by bequest. Accordingly, the value of any such additional part of the residue passing to the surviving spouse can

not be included in the amount of the marital deduction.

2. The court of appeals correctly rejected petitioner's contention that the charitable deduction under Section 2055 should be based upon the actual distributions to the Foundation and that the IRS erred in reducing the deduction by the administrative expenses. The amount of the total assets ultimately transferred to charity from post-mortem income is irrelevant to the amount of the estate tax charitable deduction. The amount of the charitable deduction on the estate tax return depends only on the actual amount passing to charity from assets included in the gross estate. See 26 U.S.C. 2055(d); *Bowes* v. *United States*, 593 F.2d at 275 (decedent's estate cannot increase its charitable deduction by gifts from post-mortem income passing to charity).

For gifts to charity from post-mortem income, a charitable deduction is permitted on the fiduciary *income* tax return. 26 U.S.C. 642(c). As the court of appeals correctly determined, "[t]hat the charitable donation was augmented by post-mortem income, resulting in an overall charitable donation of an amount greater than the estate tax deduction claimed, does not increase the amount of the charitable bequest under the will" (Pet. App. 13a).

3. The court of appeals did not err in disregarding the unopposed Florida probate court order that allowed petitioner to pay administrative expenses from post-mortem income. The proper accounting of administrative expenses on a federal estate tax

return is a question of federal law, not state law.[3] See *Morgan* v. *Commissioner*, 309 U.S. 78, 80-81 (1940). As this Court has observed, "when the application of a federal statute is involved, the decision of a state trial court as to an underlying issue of state law should *a fortiori* not be controlling." *Commissioner* v. *Estate of Bosch*, 387 U.S. at 465. Under the applicable federal law, as the court of appeals correctly noted (Pet. App. 8a-9a), the ultimate source of payment for administrative expenses is not pertinent to the estate tax charitable deduction: "regardless of the source of payments for administrative expenses, such payments are charges against the gross estate and must be accounted for accordingly" (*id.* at 12a).

4. The decision in this case does not conflict with *Estate of Warren* v. *Commissioner*, 981 F.2d 776 (5th Cir. 1993). Under the decedent's will in *Warren*, the charities were to receive annuities for 20 years at the rate of 8 1/2% of the initial fair market value of the trust assets. The charities litigated with the remaindermen in state probate court over the source for payment of the administrative expenses. The parties ultimately settled the suit. The stipulated final judgment provided that 27 1/2% of the administrative expenses would be charged to the estate's corpus and the balance would be charged to residuary post-mortem income. In a suit by the estate challenging the Commissioner's determination of an estate tax

[3] In any event, Florida law is not to the contrary. Although it permits the personal representative to use all the estate's assets, including post-mortem income, to pay its debts, it expressly requires administrative expenses to be charged to estate principal. See Fla. Stat. Ann. §§ 733.608, 738.05(1) (West 1991).

deficiency, the Fifth Circuit held that the Tax Court was bound by the state court judgment and that the charitable donation claimed on the estate tax return was to be reduced by 27 1/2% (and not 100%) of the administrative expenses. The Fifth Circuit concluded that the general rule—that a state probate court decision is not controlling in the characterization of items under the federal estate tax—only applies when the probate court's decision resulted from nonadversarial proceedings and does not apply when "the litigation, and its settlement, were to resolve adversarial, nontax, *bona fide* disputes between the parties." *Id.* at 783. As the court of appeals concluded here, however, the analysis of *Warren* does not apply to this case, for it is undisputed that "there was no *bona fide* adversarial proceeding leading to the Florida probate court's decision" (Pet. App. 16a).

Moreover, in *Estate of Warren*, the court further emphasized that "for purposes of section 2055 what is received [as a charitable gift from the estate] must be received *from the decedent*, and not merely from those who take the decedent's estate" (981 F.2d at 782). While the settlement in *Estate of Warren* determined the amount that the charities received "from the decedent," in the present case, the increased monies received by the charity were unquestionably attributable to post-mortem income and not to the decedent's estate (Pet. App. 13a). There is thus no conflict between the decision in *Estate of Warren* and the decision in this case.

5. The other cases on which petitioner relies (Pet. 11-15) also do not conflict with the decision in this case. In *Harrison* v. *Northern Trust Co.*, 317 U.S. 476, 480 (1943), this Court held that the charitable

deduction is reduced by the amount of the federal estate taxes because payment of the taxes reduces the amount actually passing from the decedent to charity. In *Estate of Luehrmann* v. *Commissioner*, 287 F.2d 10, 16 (8th Cir. 1961), the court of appeals noted that "[t]he record is completely silent as to the source of the funds used to pay the administration expenses" and sustained the Commissioner's position that the charitable deduction is reduced by those expenses. In *Estate of Street* v. *Commissioner*, the court held that the marital deduction is reduced by administrative expenses paid from either principal or income, but not by interest expense on inheritance and estate taxes. 974 F.2d at 728. Interest expense is treated differently because it accrues after death; estate income used to pay that expense therefore would not affect the size of the gross estate. *Ibid.* Finally, *Estate of Wright* v. *United States*, 677 F.2d 53 (9th Cir.), cert. denied, 459 U.S. 909 (1982), and *Oetting* v. *United States*, 712 F.2d 358 (8th Cir. 1983), addressed issues that are not presented in this case. *Estate of Wright* involved the deductibility under 26 U.S.C. 642(c)(2) of payments to charity on the estate's *income* tax return. And, *Oetting* involved the deductibility of amounts given to charity without regard to the rules of Section 2055(e)(2) for split-interest bequests. The decisions in those cases do not create a conflict with the decision in this case.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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